



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	<b>08/17/05</b>	Bill No:	<b>AB 777</b>
Tax:	<b>Sales and Use Income</b>	Author:	<b>Nunez</b>
Related Bills:			

### BILL SUMMARY

This bill would authorize an income tax credit to be administered by the Franchise Tax Board (FTB) for qualified wages or qualified property, as defined, paid or incurred during the production period of a qualified motion picture production or a qualified commercial production, as specified and defined.

In lieu of claiming the qualified motion picture production credit, the bill would allow, until January 1, 2016, qualified taxpayers to claim either a refund of sales or use tax paid under the Sales and Use Tax Law, or a credit against a sales or use tax liability, that is equal to the income tax credit amount that would otherwise be allowed pursuant to the income tax laws.

### Summary of Amendments

The prior version of this bill did not fall within the purview of the Board.

### ANALYSIS

#### Current Law

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property in this state. The use tax is imposed on the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless that property is specifically exempted.

With regard to the motion picture industry, the Sales and Use Tax Law provides the following:

- Section 6378 of the Sales and Use Tax Law provides an exemption from the 5.25 percent state sales and use tax, for the sale and purchase of any tangible personal property purchased for use in teleproduction or other post production activities, as described, by a qualified person that is *primarily* engaged in teleproduction or post production services, as defined pursuant to the North American Industry Classification System Manual, published by the United States Office of Management and Budget, 1997 edition.

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- Section 6010.4 provides that when certain persons form partnerships to reduce the cost of producing motion pictures through sharing of equipment and other assets, the furnishing of that property, without transfer of title, by the partnership to its members for the purpose of producing motion pictures does not constitute a “sale” and, therefore, no tax applies to the furnishing of that property.
- Section 6010.6 provides that “sale” and “purchase” do not include the following: 1) any transfer of any qualified motion picture or any interest or rights therein when the transfer is prior to the date that the qualified motion picture is exhibited or broadcast to its general audience, and 2) the performance of qualified motion picture production services, as defined, in connection with the production of any qualified motion picture, as defined. Therefore, no tax applies to these transactions.
- Leases of motion pictures, animated motion pictures, and television films and tapes (except video cassettes, tapes, and discs leased for private use under which the lessee does not obtain the right to license or broadcast) do not constitute “sales.” Therefore, the lessor is the consumer of the property he or she leases and is required to pay tax on his or her cost of the property.

### **Proposed Law**

This bill would add Section 6902.5 to the Sales and Use Tax Law, Section 17053.85 and 17053.86 to the Personal Income Tax Law, and Section 23685 and 23686 to the Corporation Tax Law, and amend Section 23036 of the Corporation Tax Law, to do, among other things, the following:

1. Allow a credit to a qualified taxpayer against the personal income tax or the corporation tax an amount equal to 12 percent of the qualified amount, not to exceed \$3 million per qualified motion picture, and an additional 3 percent for specific qualified motion pictures.
2. Define “qualified taxpayer” as a taxpayer who has paid or incurred the expenses for the qualified amount, and has been allocated tax credits by the California Film Commission (CFC).
3. Define “qualified amount” as the total amount paid or incurred after 01/01/06 during the production period for qualified wages and qualified property with respect to the production of each qualified motion picture.
4. For purposes of the proposed motion picture production credit, define “qualified property” as tangible personal property used primarily in the production of a qualified motion picture
5. Define “qualified motion picture,” to mean, among other things, a feature with a minimum budget of \$500,000 and a maximum budget of \$75 million. It would exclude from the definition productions such as news programs, talk shows, game shows, awards shows, private noncommercial productions (e.g., weddings or graduations).

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6. Require the CFC to determine and designate who is a qualified taxpayer and allocate tax credits up to an unspecified amount to qualified taxpayers, as provided, and provide a list to the Board with specified information.
7. Until January 1, 2016, allow qualified taxpayers, in lieu of claiming the motion picture production credit, to either claim a refund of sales or use tax paid, or a credit against liability for sales or use tax due, that is equal to the credit amount that would otherwise be allowed under Sections 17053.85, or 23685.

The bill would become effective immediately.

### **Background**

Section 6378 was added to the Sales and Use Tax Law in 1998 by AB 2798, Chapter 323. The purpose of that measure was to provide a tax incentive for postproduction work to ensure that the entertainment industry continues to thrive in California. The sponsor of that exemption was the Worldwide Trade Association of Post Production. For fiscal year ending 2004, the sales and use tax exemptions claimed during that year amounted to \$13.5 million.

### **COMMENTS**

1. **Sponsor and purpose.** The bill is sponsored by the author. The author's office notes that California's dominance as the premier location for movie, television, and commercial production is being eroded by competition from other states and foreign countries. This bill is therefore intended to create incentives in the law to discourage the practice of producing and filming motion pictures and commercials outside California.
2. **This analysis focuses primarily on the provisions contained in proposed Section 6902.5 which would fall under the Board's purview.** Some implementation concerns are noted below:
  - **Shouldn't the FTB administer the refunds?** The Board would be required to make refunds or approve credits based on provisions administered by the FTB. Since the FTB has the expertise in administering the Personal Income Tax Law and the Corporation Tax Law, it appears more appropriate to retain administration of this credit mechanism within that agency.

- **The bill should define “sales or use taxes paid.”** The bill would allow a qualified taxpayer to claim a refund or credit of sales or use taxes paid. It is unclear what this provision means. Would this include payments of sales tax reimbursement or use tax to other retailers? Does it mean the amount of sales or use tax paid to the Board as far back as when the taxpayer began filing sales and use tax returns? Does the amount include local and district taxes?
- **Subdivision (f) of proposed Section 6902.5 is confusing.** This proposed section would limit the allowable refund to the amount of sales and use tax paid, yet the bill states that any refund approved by the Board which may exceed the sales and use tax paid shall be payable from the General Fund. Upon what basis would the Board approve a refund in excess of the sales and use tax paid? If the author intends to enable production companies to receive up to \$3 million per production, perhaps a grant program would be a better approach.
- **The impact to the Board appears to be minimal, unless we have to verify sales or use tax paid to other retailers.** Subdivision (h) would require the California Film Commission to provide a list of the taxpayer names, and other related information, to the Board with the total amount of the tax credit allocated to each qualified taxpayer. Other than simply doing the necessary paperwork to generate the refund or apply the credit, it appears the Board would have a minimal role in this credit proposal. However, the term “sales or use taxes paid” should be clearly defined in order for the Board to determine the actual impact this bill could have.
- **The Board should be authorized to share information with the CFC.** When the Board makes a refund, or applies a credit to a sales or use tax liability, it appears it would be essential that the CFC be made aware so that it could ensure that the total allowable credits do not exceed the allowable cap (currently unspecified in the bill). However, the bill doesn’t authorize the Board to do so. Section 7056 of the Sales and Use Tax Law prohibits the Board from releasing tax information about taxpayers to outside persons or agencies, unless the Governor authorizes such a release. Either Section 7056 would require an amendment to authorize the Board to release information to the CFC regarding refunds or credits issued, or a special order from the Governor would be required.
- **Subdivision (g) is confusing.** The bill specifies that interest shall not apply to any return claiming a credit. However, is it the author’s intent to allow interest on any refunds claimed? What about a return that is filed that has a credit due – would interest apply to that credit amount?

## **COST ESTIMATE**

It is unclear how many taxpayers would actually be approved by the CFC for the proposed tax credit, since the bill would require CFC to process and approve (or reject) all applications on a first-come first-served basis. This could mean that, depending on the total allowable credit (currently unspecified in the bill), the first applicant could absorb the entire allowable credit, leaving no additional tax credits for any other taxpayers, and the Board would only be processing one refund.

On the other hand, the bill needs more specificity with regard to defining “sales or use taxes paid” and the Board’s role in this credit proposal. If the intent of the bill is to allow a refund up to the amount of sales or use tax paid by the qualified taxpayers to other retailers, administrative costs would be incurred by the Board to make those verifications. Yet, the extent of these costs is unknown due to the uncertainty on how many qualified taxpayers would be allocated tax credits for which the Board would be required to audit.

If the intent of the bill is to simply authorize the Board to issue refunds based on CFC’s allocations, the administrative costs would be minimal. “Minimal” costs is based on the assumption that the CFC would make the notification to qualified taxpayers of the allowable credits and make the necessary verifications that the taxpayers have actually incurred the costs upon which the credit is based.

With the above uncertainties, it is premature to estimate the administrative costs to the Board.

## **REVENUE ESTIMATE**

The bill would require the CFC to determine and designate qualified taxpayers and the amount of tax credit. The bill would provide an in-lieu credit against sales and use taxes paid for amounts otherwise allowed under the proposed income tax provisions. The bill would place a cap on the maximum amount of allowable income tax credits, both in the aggregate for all taxpayers (which is currently unspecified in the bill), and with regard to each qualified motion picture. The bill would provide that the maximum allowable credit for each qualified motion picture shall not exceed \$3 million.

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